U.S.
JAN 11 2010

No. 09-682

IN THE

Supreme Court of the United States

LEONARD BOSACK, *et al.*,

Petitioners,

v.

DAVID C. SOWARD, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether this Court should grant certiorari to decide whether punitive damage awards in private, voluntary arbitration should be subject to heightened judicial review for excessiveness, where the Federal Arbitration Act as authoritatively interpreted by this Court in *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 128 S. Ct. 1396 (2008) precludes such review, Petitioners did not seek such review below, and there is no conflict among the lower courts on the issue.

DISCLOSURE STATEMENT

Respondent David C. Soward is an individual. Respondent & Management Company has no parent corporation, and no publicly held company owns 10% or more of its stock.

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STATUTORY PROVISIONS INVOLVED

The Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* ("FAA"), supplies the mechanisms for enforcing arbitration awards. Under the terms of Section 9 of the FAA, a court "must" confirm an arbitration award "unless" it is vacated, modified or corrected "as prescribed in §§ 10 and 11." 9 U.S.C. § 9. Section 10(a) lists the grounds for vacating an award as follows:

> (a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration
>
> (1) where the award was procured by corruption, fraud, or undue means;
>
> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
>
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or

> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10(a).

STATEMENT OF THE CASE

A. Soward's Business Relationship With Bosack and Lerner

In the 1990s, Petitioners Leonard Bosack and Sandy Lerner, the founders of Cisco Systems, Inc., hired Respondent David Soward to manage their considerable personal wealth. Pet. App. at 5a, 48a. Several years into Soward's tenure, Soward and Bosack formed Cartesian Partners L.P. ("Cartesian"). *Id.* at 5a. Soward was the general partner and invested his own money; Bosack was a limited partner. *Id.* at 5a, 101a-102a. As of 2003, Soward's capital interest in Cartesian was $1,001,101. *Id.* at 102a.

In 2002, Soward asked Bosack and Lerner to extend his contract and increase his compensation for his services as their investment manager. *Id.* at 104a. Bosack and Lerner responded by firing Soward. *Id.* Bosack purported to terminate Soward as general partner of Cartesian, despite having no signed agreement permitting him to do so. *Id.* at 5a, 107a. Contending that Soward had no "lawful interest" in Cartesian, Bosack and Lerner jointly formed a new entity called SLLB, LLC ("SLLB") to replace Soward as the general partner.

Id. at 103a, 108a. Without telling Soward, they filed a false tax return reducing Soward's capital account from $1,001,101 to $135,889, "or in the alternative to zero." *Id.* at 106a, 121a. SLLB took over the assets of Cartesian, and Bosack and Lerner refused to provide Soward with an accounting of his interest until they were ordered to do so by the arbitrators in 2006. *Id.* at 106a, 120a-25a.

B. The Arbitration Proceedings

The parties voluntarily submitted to arbitration all of the claims and counterclaims between them. *Id.* at 51a. Each side sought, among other relief, punitive damages from the other. *Id.* at 68a-69a. The arbitration proceedings lasted two years, during which time the panel of arbitrators held more than sixty days of hearings, heard the testimony of four experts and approximately twenty-six witnesses, and received over five hundred exhibits into evidence. *Id.* at 52a. The arbitrators were among the most experienced and respected panelists in California, and gave careful consideration to all of the parties' evidence and contentions, issuing 52 written hearing orders, five Interim Awards, and one Final Award. *See id.* at 51a-52a.

Soward prevailed on all claims that he brought. As to Cartesian, the arbitrators found that Bosack and Lerner intentionally sought to hurt Soward by engaging in "a planned, malicious, [and] purposeful attempt to take Soward's interest in Cartesian away from him and convert[ing] it for Bosack's use." *Id.* at 58a-59a. In Interim Award No. 3, the arbitrators found that Soward was entitled to an accounting of his interest in Cartesian

as of September 30, 2006, valued at $1,464,391. *Id.* at 6a, 54a. In Interim Award No. 4, the arbitrators found Bosack liable in tort for breach of fiduciary duty, and both Bosack and Lerner liable for unjustifiable conversion of Soward's interest in Cartesian. *Id.* at 6a-7a. They awarded $1,001,101 plus prejudgment interest on both tort claims, with this amount "deemed satisfied" by payment of the accounting award. *Id.* at 122a-23a.

Based on "clear and convincing" evidence of Petitioners' malice, the arbitrators made two separate punitive damage awards against Bosack and Lerner in Interim Award No. 5. *Id.* at 91a-92a. The arbitrators awarded punitive damages of $10,999,494 against Bosack, using a 9:1 multiplier measured against compensatory damages of $1,222,166 (principal and interest) on the tort claims. *Id.* at 92a, 96a. They awarded $8,555,162 in punitive damages against Lerner using a multiplier of 7:1. *Id.* at 92a, 96a.

To set the amount of punitive damages, the arbitrators engaged in a two-part analysis. First, they applied California law to "determine an amount that will have the proper deterrent effect and ensure that malicious and oppressive conduct is not repeated," in light of each defendant's high net worth. *Id.* at 92a. Second, after applying state law standards, the arbitrators emphasized that,

> [O]ne must determine whether or not the amount proposed is consistent with the Due Process standard of the 14th Amendment, as established by the U.S. Supreme Court in *BMW v. Gore* (1996) 517 U.S. 559 and

> *State Farm v. Campbell* (2003) 123 S.Ct. 1513. Significantly, in *Rifkind & Sterling, Inc. v. Rifkind* (1994) 28 Cal. App. 4th 1282, 1290-1293, 33 Cal.Rptr.2d 828, the court held that because of the lack of state action, a private contractual arbitration is not subject to the strictures of the due process clause. Notwithstanding *Rifkind*, the Panel has endeavored to follow the due process guidelines set forth in *BMW v. Gore* and successor cases.

Id. at 92a-93a.

The arbitrators devoted an entire section of Interim Award No. 5 to the application of *BMW* and *State Farm* to the facts of the case, examining the reprehensibility of Petitioners' conduct, the appropriate ratio between the compensatory and punitive damage awards, and the civil penalties authorized for similar misconduct. *Id.* at 94a-97a. With respect to the first issue, the arbitrators concluded, "[m]easuring the actions of Respondents against the five-point scale of *State Farm*, we find the actions of Bosack and Lerner [h]ighly reprehensible." *Id.* at 95a. The arbitrators concluded that, on the facts of the case, a relatively high punitive damages ratio was necessary to provide a meaningful deterrent. *Id.* at 96a-97a. Finally, the arbitrators relied on California authority to ensure that, consistent with *State Farm*, the punitive damages awards were in line with civil penalties authorized or imposed for comparable misconduct. *Id.* at 97a.

C. The District Court Proceedings

Bosack and Lerner filed separate petitions in the district court in Seattle seeking to vacate the punitive damage awards pursuant to Section 10(a)(4) of the Federal Arbitration Act. *Id.* at 47a, 61a. Both argued that in setting the punitive damages, the arbitrators "manifestly disregarded" this Court's rulings in *State Farm* and *BMW* by awarding punitive damage awards that (when added together) were sixteen times the compensatory damages award. *Id.* at 60a.[1] Neither Bosack nor Lerner contended that due process required the district court to perform a general review of the arbitration panel's award of punitive damages.

The district court held that due to the limited scope of review permitted under the FAA, it could not vacate the award for purported errors of law or fact. Pet. App. at 61a-62a. The court also stated that it "cannot vacate the awards based on their excessiveness." *Id.* at 69a. However, the district court did not hold that it was barred from engaging in *any* review of the punitive damage awards whatever. Instead, the court explained that under the "manifest disregard" theory, vacatur would be warranted if Petitioners could show that "the arbitrators recognized the applicable law and then ignored it." *Id.* at 62a. Because the record showed that the arbitration panel had expressly applied *BMW* to the

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1. Bosack and Lerner have since revised their math, and now contend that the ratio of punitive damages to compensatory damages was twenty to one. Pet. at 2, 7.

facts of the case, the court upheld the awards in full. *Id.* at 59a, 69a.

D. The Ninth Circuit's Decision

On appeal, Petitioners again argued that the awards should be vacated because the arbitrators had manifestly disregarded the law. Petitioners conceded that "while a punitive damages award in arbitration *may not be subject to heightened review for excessiveness*, it must be subject to the judicial review ordinarily applied to arbitration awards." Lerner's Opening Br. On Appeal, Appeal Nos. 08-35248 and 08-35458 (Oct. 28, 2008) ("Appellate Brief"), at 60-61 (emphasis added).

The Ninth Circuit affirmed the district court's decision. In applying the "manifest disregard" standard urged by Petitioners, the Ninth Circuit explained that an arbitrator does not "exceed its powers" under the FAA by making an error of law or fact, but instead does so only where it is "clear from the record that the arbitrator [] recognized the applicable law and then ignored it." Pet. App. at 11a (citations omitted). The Ninth Circuit found no basis in the record to conclude that standard met here, emphasizing that "the panel extensively discussed and then applied both *State Farm* and *BMW*" and that "Bosack and Lerner have failed to show that the panel demonstrated a manifest disregard of the law in issuing the award." *Id.* at 14a.

The Ninth Circuit stated in *dicta* that it agreed with the district court's holding that it could not vacate the arbitration awards at issue for excessiveness. *Id.* at 14a. However, it did not analyze whether a right of due process under the federal constitution as found in *State Farm* and *BMW* requires a court to engage in *de novo* or heightened review of private arbitration awards. Nor did it address whether judicial confirmation of arbitral awards constitutes state action. Moreover, while Petitioners argued for the first time on appeal that judicial confirmation of arbitral awards furnishes the necessary state action to trigger due process concerns, those arguments were offered in support of limited review for manifest disregard of the law, not enhanced *State Farm* review, which Petitioners conceded did not apply. Appellate Br. at 59-61. Rather, Petitioners argued that due process concerns compel district courts to subject punitive arbitral awards "to the *same* review as other aspects of arbitration awards, and therefore, where arbitrators award punitive damages in manifest disregard of the law, those damages must be vacated." *Id.* at 57 (emphasis added).

REASONS FOR DENYING THE PETITION

I.

THE QUESTION PETITIONERS PRESENT FOR REVIEW WAS NEITHER RAISED NOR RESOLVED BELOW, AND IS FORECLOSED BY THIS COURT'S DECISION IN *HALL STREET ASSOCIATES*.

Petitioners ask this Court to decide "[w]hether an arbitral award of punitive damages is subject to constitutional constraints on excessiveness," contending that certiorari is warranted because the Ninth Circuit "refused to review the award to determine whether it was excessive under this Court's due process precedents." Pet. at 1. Even more broadly, Petitioners argue for the first time in this Court that the manifest disregard standard they urged the lower courts to apply "does not satisfy the constitutional standard of "meaningful" and "adequate" review of an award of punitive damages." *Id.* at 16. The Court should deny certiorari because Petitioners never raised those issues in the lower courts, which therefore did not reach them. Even more fundamentally, Petitioners' attack on the manifest disregard standard is squarely foreclosed by this Court's recent holding in *Hall Street Associates*, which narrowly limits judicial review of arbitration awards under the Federal Arbitration Act.

A. Petitioners Successfully Urged The Lower Courts To Apply The Manifest Disregard Standard.

In the lower courts, Petitioners consistently challenged the award on the ground that in awarding punitive damages, the arbitrators had "manifestly disregarded" the law. Petitioners now reverse course, asserting that due process requires a broader, *State Farm*-like review of arbitral awards of punitive damages. Indeed, they argue for the first time in this Court that the manifest disregard standard they urged the Ninth Circuit to apply below itself violates due process. However, having failed to raise these contentions below, Petitioners are barred from raising them in this Court for the first time. *E.g.*, *Bivens v. Six Unknown Named Agents of Federal Bureau of Narcotics*, 403 U.S. 388, 396 (1971)(a question is not properly before the Court where it was not raised or resolved in the court of appeals).

Petitioners urged the lower courts to vacate the arbitration award on the ground that the arbitrators "manifestly disregarded" the law. Indeed, they admitted below that a punitive damages award in arbitration "may not be subject to heightened review for excessiveness," and that they were only seeking the judicial review "ordinarily applied to arbitration awards." Appellate Br. at 60-61. That "ordinary" standard referred to the narrowly limited review available under Section 10(a)(4) of the FAA, under which a court may vacate an arbitration award only if the arbitrators "exceeded their powers" by "manifestly disregarding the law." While Petitioners raised due process arguments below, those arguments were insufficient to preserve the constitutional issue now framed by Petitioners because they were offered only in support of

limited review under the FAA, not—as Petitioners now suggest—enhanced, *State Farm* review under the Due Process Clause of the Fifth Amendment. *See Browning-Ferris Indus. of Vermont, Inc. v. Kelco Disposal, Inc.*, 429 U.S. 257, 277 (1989)(holding that due process challenge to punitive damage award must be directly raised below for purposes of preserving for certiorari).

Understandably in light of Petitioners' position below, the Ninth Circuit did not reach or resolve the issue they now seek to raise. That court reviewed the awards for manifest disregard of the law without analyzing any constitutional due process issues, including the threshold question of whether voluntary private arbitration involves state action. Pet. App. at 33a. Thus, its passing agreement with the district court that it could not vacate the award for excessiveness was, at best, *dicta*, which is not a proper subject of review. *California v. Rooney*, 483 U.S. 307, 311 (1987)("This Court reviews judgments, not statements in opinions") (quoting *Black v. Cutter Laboratories*, 351 U.S. 292, 297 (1956)).

B. Petitioners' Position Is Foreclosed By Controlling Authority.

Petitioners do not make any effort to reconcile their contention that arbitration awards should be subject to a heightened, *State Farm* judicial review for excessiveness with this Court's ruling in *Hall Street Associates*. Instead, the petition simply makes no reference at all either to the FAA or to *Hall Street Associates*.

Petitioners' position is flatly foreclosed by this Court's recent, authoritative decision in *Hall Street Associates*. There, the Court squarely held that Section

10(a) of the FAA sets forth the "exclusive" grounds for vacatur of an arbitration award. 128 S. Ct. at 1403; *accord id.* at 1400 ("We hold that the statutory grounds are exclusive").[2] Those exclusive grounds do not include an inquiry into whether an award is "excessive." The Court reaffirmed the continued vitality of the "manifest disregard of the law" standard, strongly suggesting that standard is coextensive with the statutory grounds for vacatur found in Section 10. *Id.* at 1404. And it reaffirmed the long-standing prohibition against courts conducting a "general review for an arbitrator's legal errors." *Id.* at 1404; *see also, e.g., United Paperworks Intl Union, AFL-CIO v. Misco, Inc.*, 484 U.S. 29, 38 (1987)("[T]hat a court is convinced [the arbitrator] committed serious error does not suffice to overturn his decision").

Petitioners' argument in favor of full-blown *State Farm* review of arbitral awards amounts to an unspoken constitutional challenge to the constitutionality of the FAA as applied to arbitrators' awards of punitive damages. Petitioners' position cannot be reconciled with this Court's recent holding in *Hall Street Associates*. The petition should be denied on that ground alone.

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2. The Court rejected the argument that review of arbitration awards for "manifest disregard of the law" confers expanded authority on courts to review arbitration awards. 128 S. Ct. at 1404.

II.

THERE IS NO CONFLICT AMONG THE LOWER COURTS OR OTHER GROUND WARRANTING CERTIORARI.

Petitioners assert that certiorari is appropriate because the lower courts are in "disarray" over "the important question" of whether "arbitral awards of punitive damages are subject to the constitutional constraints of due process." Pet. at 8, 11. In fact, there is no such conflict among lower courts on this issue. The great weight of authority, including every federal circuit to have addressed the issue, holds that voluntary private arbitration proceedings do not involve state action and cannot give rise to due process claims. Petitioners do not cite a single case that endorsed a heightened, *State Farm*-like review of arbitral awards for excessiveness. Likewise, Petitioners do not cite a single case—and, to our knowledge, there is none—in which a court overturned an arbitral award of punitive damages on the ground that it was unconstitutionally excessive.

A. The Overwhelming Weight Of Authority Holds That Voluntary Private Arbitration Does Not Constitute State Action And Cannot Give Rise To A Due Process Claim.

The great weight of authority rejects the notion that a litigant disappointed with the outcome of a private, voluntary arbitration proceeding can challenge the arbitration award on due process grounds. Thus, virtually every court to have squarely addressed the

issue, including every federal circuit to have done so, has concluded that voluntary private arbitration does not constitute state action sufficient to trigger due process review. *E.g.*, *Davis v. Prudential Secs., Inc.*, 59 F.3d 1186, 1191-92 (11th Cir. 1995)("We agree with the numerous courts that have held that the state action element of a due process claim is absent in private arbitration cases"); *Federal Deposit Ins. Corp. v. Air Florida Sys., Inc.*, 822 F.2d 833, 843 n.9 (9th Cir. 1987), *cert. denied*, 485 U.S. 987 (1988) ("Although Congress . . . has provided for some governmental regulation of private arbitration agreements, we do not find in private arbitration proceedings the state action requisite for a constitutional due process claim"); *Elmore v. Chicago & Illinois Midlands Ry. Co.*, 782 F.2d 94, 96 (7th Cir. 1986)("[T]he fact that a private arbitrator denies the procedural safeguards . . . cannot give rise to a constitutional complaint"); *Austern v. Chicago Bd. Options Exch., Inc.*, 716 F. Supp. 121, 125 (S.D.N.Y. 1989), *affd*, 898 F.2d 882 (2d Cir. 1990), *cert. denied*, 498 U.S. 850 (1990) (holding that arbitration panel's conduct "did not in any way constitute state action"); *Intl Ass'n of Heat & Frost Insulators and Asbestos Workers Local Union 42 v. Absolute Envtl. Svcs., Inc.*, 814 F. Supp. 392, 402-03 (D. Del.1993)(no state action in arbitration proceedings pursuant to collective bargaining agreement between private parties).

The rationale for this broad consensus that contractual arbitration does not constitute state action is straightforward:

> Private arbitration, however, really is private; and since constitutional rights are in

> general rights against government officials and agencies rather than against private individuals and organizations, the fact that a private arbitrator denies the procedural safeguards that are encompassed by the term "due process of law" cannot give rise to a constitutional complaint.

Elmore, 782 F.2d at 96; *accord*, *Davis*, 59 F.3d at 1191 (arbitration is "a private proceeding arranged by a voluntary contractual agreement of the parties.") *Porush v. Lemire*, 6 F. Supp. 2d 178, 186 (E.D.N.Y. 1998)("Simply put, private arbitrators are not state actors and, absent state action, there can be no violation of either amendment"); *Rifkind & Sterling, Inc. v. Rifkind*, 28 Cal.App. 4th 1282, 1292, 33 Cal.Rptr.2d 828, 834 (1994)("the legal and practical reality" is that "an arbitration award is not a product of public law or state proceedings, but rather is a private arrangement, governed by rules of the parties' own making or selection").

There is also widespread agreement that "mere confirmation of a private arbitration award by a district court is insufficient state action to trigger the application of the Due Process Clause." *Davis*, 59 F.3d at 1192; *see also, e.g.*, *Smith v. American Arbitration Ass'n, Inc.*, 233 F.3d 502, 507 (7th Cir. 2000)(judicial enforcement of arbitration contracts "does not convert the contracts into state or federal action and so bring the equal protection clause into play") (citations omitted); *MedValUSA Health Programs, Inc. v. Memberworks, Inc.*, 872 A.2d 423, 434-35 (Conn. 2005)("Almost universally, courts have concluded that

judicial confirmation of an arbitration award is not sufficient to convert the action of an arbitrator into state action") (collecting authorities).

Other courts, without reaching the state action issue, have rejected due process challenges to arbitration awards (including arbitral awards of punitive damages) on the ground that parties that voluntarily enter into arbitration agreements may not later assert that the limited judicial review of arbitration awards afforded by the Federal Arbitration Act violates due process:

> Cunard had every opportunity to present evidence, to argue the merits of its position, and to challenge the arbitrator's award in court. Having taken advantage of this process, into which it entered voluntarily, Cunard cannot now argue that its due process was denied.

Todd Shipyards Corp. v. Cunard Line, Ltd., 943 F.2d 1056, 1063-64 (9th Cir. 1991); *see also, e.g.*, *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 940 (10th Cir. 2001)("[Appellant] may not now oppose the very process it advocated and to which it voluntarily submitted"); *Barnes v. Logan*, 122 F.3d 820, 824 (9th Cir. 1997), *cert. denied*, 523 U.S. 1059 (1998) (rejecting contention that award of punitive damages by arbitrators should be subject to "heightened scrutiny"); *Glennon v. Dean Witter Reynolds, Inc.*, 83 F.3d 132, 138-39 (6th Cir. 1996)(FAA affords "meaningful review" of claims that no evidence supports an arbitration panel's award of punitive damages arbitration awards, and therefore does

not violate due process); *Smith*, 233 F.3d at 506-07("By agreeing to arbitrate in a setting in which [the opposing party] if it prevailed could seek confirmation under the Federal Arbitration Act, [appellant] bound herself to accept the limited judicial review which that act allows").

B. The Few Decisions Petitioners Rely Upon Do Not Give Rise To Any Conflict.

Petitioners erroneously assert that certiorari is warranted because there is a conflict on the question whether arbitral awards of punitive damages are subject to due process review for excessiveness. Pet. at 8-12. In fact, Petitioners do not cite a single case holding that the limited judicial review permitted by the FAA must give way to the heightened, *State Farm* review for excessiveness of arbitral awards that Petitioners now seek. In particular, there is not "a single case holding that an award of punitive damages by an arbitrator is in any way unconstitutional." *Davis*, 59 F.3d at 1192.

The handful of lower court decisions on which Petitioners rely do not give rise to any conflict, much less a well-developed conflict, warranting review by this Court. One bankruptcy court expressed the view that judicial enforcement of arbitration agreements could be considered state action, but that court ultimately acknowledged it was bound by the Eleventh Circuit's opinion in *Davis v. Prudential Secs., Inc.*, 59 F.3d 1186 (11th Cir. 1995), and that the arbitration clause was *not* subject to scrutiny under the Due Process Clause. *In re Knepp v. Credit Acceptance Corp.*, 229 B.R. 821, 841 (Bankr. N.D. Ala. 1999). Further, that discussion was pure *dicta*, as the court had already concluded that there

was no enforceable arbitration agreement because neither party had signed the arbitration clause. *Id.* at 834, 836-37. Finally, the case did not involve a challenge to an award of punitive damages, but instead a party's opposition to a motion to compel arbitration on the ground that the arbitration clause's limitation on his ability to conduct discovery would violate due process. *Id.* at 840.

Likewise, the district court in *Sanders v. Gardner*, 7 F. Supp. 2d 151 (E.D.N.Y. 1998), followed *Davis* in holding that imposition of punitive damages in arbitration did *not* violate due process. *Id.* at 173-74 ("The assertion that the arbitrators' imposition of punitive damages is violative of due process because there is no protection against arbitrary results, is also unsupported by precedent"). While the court appeared to assume, without deciding, that arbitral awards of punitive damages could be constitutionally excessive (*id.* at 176-79), it also acknowledged that the award could be vacated only if the arbitrators had "manifestly disregarded the law" in reaching their decision. *Id.* at 158-59. And the court upheld an award of $10 million in punitive damages and $184,583 in compensatory damages—a ratio of more than 54 to 1—based on a finding that "the Arbitrator's punitive damages award cannot be said to be a manifest disregard of the law." *Id.* at 170, 177-79.

In *Sawtelle v. Waddell & Reed, Inc.*, 304 A.D.2d 103 (N.Y. App. Div. 2003), an intermediate state appellate court, citing *Davis*, observed that "there is ample authority for the proposition that private arbitration does not implicate due process concerns since, where

the parties have voluntarily participated in the arbitration process, there is no state action involved, not even in the judicial confirmation of the punitive damage award." *Id.* at 109-10. The court did not decide the due process issue, which it characterized as "besides the point"; instead, it referred to *BMW* solely as a guideline to determine whether the award should be vacated as "arbitrary and irrational." *Id.*; *see also id.* at 110 (*Gore* test "has application outside the realm of a due process claim in a review of a punitive damage award"). Moreover, that was only an alternative ground, as the court also found that the manifest disregard standard was satisfied. *See id.* at 113-14 ("in awarding $25 million in punitive damages, the panel completely ignored applicable law, an error that provides a separate basis for vacating the award"). In any event, *Sawtelle* is of doubtful validity, because that an award is "arbitrary and irrational" is not among the exclusive statutory grounds for vacatur. *See Hall Street*, 128 S. Ct. at 1400.

Finally, in *Birmingham News Co. v. Horn*, 901 So.2d 27 (Ala.2004), the Alabama Supreme Court suggested that there was sufficient state action inherent in court orders compelling arbitration to justify review of the awards under federal due process considerations. *Id.* at 66. However, the court grounded its ruling affirming the punitive damages award in that case squarely on the "manifest disregard" standard. *See id.* at 66-69. It upheld the award of punitive damages under that standard, explaining that "the panel presented an extensive explanation of the numerous factors and criteria it considered in arriving at its assessment of punitive damages . . . and it certainly cannot be said that it completely ignored or disregarded the legal

principles laid down in [*BMW*] and [*State Farm*]." *Id.* at 69.[3] Thus, at most *Birmingham News* stands for the proposition that arbitrators should consider *State Farm*'s due process factors, but that courts may not vacate the resulting award unless the arbitrators manifestly disregarded the law. That holding is entirely consistent with the Ninth Circuit's decision here.

C. Petitioners' Dire Predictions About the Wider Implications Of The Lower Courts Ruling Are Misplaced.

Petitioners predict that the limited judicial review of arbitral awards afforded by the FAA will create "a powerful disincentive to arbitration," leading to greater burdens on the courts, and will expose parties "to an arbitrator's virtually unchecked power to impose punishment for nothing more than ordinary commercial conduct." Pet. at 12, 13. However, Petitioners offer no evidence that any such adverse effects have occurred or will occur in the future, much less that full-blown, *State Farm* review of arbitral punitive damages awards is essential to avoid such adverse effects.

This Court rejected an identical argument in *Hall Street Associates*, where the petitioner argued that "parties will flee from arbitration if expanded review is not open to them." 128 S. Ct. at 1406. The Court found no evidence to support that prediction, and observed that even if accurate, it could provide no justification

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3. Following *Hall Street Assocs.*, that court later overruled *Birmingham News Co.* in part. *Hereford v. D.R. Horton, Inc.*, 13 So. 3d 375, 380-81 (Ala. 2009).

for rewriting the statute. *Id.* ; *see also MedValUSA Health Programs, Inc.*, 872 A.2d at 438 n.14 (dismissing as "wholly speculative" contention "that parties engaged in negotiation over contract language will decide not to include an arbitration clause *at all*, because of the possibility that, in the event of a breach, the arbitration panel will render an excessive punitive damages award that a court will not be able to overturn . . . .").

Contrary to Petitioners' dire predictions, "[t]he expertise of arbitrators and the lack of bias in the arbitral forum have caused some commentators to predict that runaway punitive damage verdicts are a problem that is likely to be reduced, rather than aggravated, by shifting disputes from courts to arbitration." *Davis*, 59 F.3d at 1192 (quoting Stephen J. Ware, *Punitive Damages in Arbitration: Contracting Out of Government's Role in Punishment and Preemption of State Law*, 63 FORDHAM L. REV. 529, 570 (1994)); *see also, e.g., MedValUSAHealth Programs, Inc.*, 872 A.2d at 438 n.14 ("Simply because we can *conceive* of an arbitration award of the magnitude hypothesized by the dissent, does not mean that such an award is likely to occur. We ought not to make rules of law based on unrealistic hypotheses").

Finally, Petitioners' argument simply ignores the practical realities of voluntary arbitration. As this Court has recognized, "parties are generally free to structure their arbitration agreements as they see fit." *Volt Info. Scis., Inc. v. Bd. of Trs.*, 489 U.S. 468, 479 (1989). Parties wishing to avoid punitive damages in arbitration may do so by expressly excluding such damages in the arbitration agreement. *See Mastrobuono v. Shearson*

Lehman Hutton, Inc., 514 U.S. 52, 58 (1995)(explaining that the availability of punitive damages in arbitration turns on the language of the arbitration contract). Alternatively, "[s]hould parties desire more scrutiny than the [FAA] authorizes courts to apply, they can contract for an appellate arbitration panel to review the arbitrator's award." *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987, 993 (9th Cir. 2003) (citation and internal quotation omitted). What they may not do is what Petitioners did here: agree to submit their dispute to arbitration, empower the arbitrators to award exemplary damages and seek such an award of damages from the other party, and then challenge an adverse award on the ground that it deprives them of due process.

III.

THE COURT OF APPEALS, IN *DICTA*, CORRECTLY CONCLUDED THAT IT COULD NOT VACATE THE ARBITRAL AWARD AS EXCESSIVE.

While the Ninth Circuit's observation that it could not vacate the punitive damage awards for excessiveness was mere *dicta*, and therefore not a proper subject of review, this Court also should deny certiorari because that conclusion was correct.

A. Voluntary Private Arbitration Does Not Constitute State Action.

Constitutional due process protections "do not extend to private conduct abridging individual rights," but only to state action. *Nat'l Collegiate Athletic Assn*

v. Tarkanian, 488 U.S. 179, 191 (1988) (quoting *Burton v. Wilmington Parking Auth.*, 365 U.S. 715, 722 (1961)). The state action concept is narrow, and applies only where the state exercises such "coercive power" or "significant encouragement" that the conduct at issue may be "fairly treated as that of the State itself." *American Mfrs. Mut. Ins. Co. v. Sullivan*, 526 U.S. 40, 52 (1999). This Court repeatedly has held that "[p]rivate use of state-sanctioned private remedies or procedures does not rise to the level of state action." *Id.* at 53 (state-sanctioned private review of workers compensation disputes is not state action) (quoting *Tulsa Prof'l Collection Servs., Inc. v. Pope*, 485 U.S. 478, 485 (1988)); *see also, e.g., Flagg Bros., Inc. v. Brooks*, 436 U.S. 149, 164-65 (1978)(post-eviction sale of property permitted under state law did not constitute state action).

The necessary element of coercive state action is not satisfied in private, voluntary arbitration for the simple reason that "arbitration under the [FAA] is a matter of consent, not coercion." *Volt Info. Scis., Inc.*, 489 U.S. at 479. No state action is necessary to enable the existence of an arbitration agreement, which is operative when signed by the parties. Nor is coercive state action necessary for an arbitrator to issue a punitive damages award pursuant to that agreement. That a court may later confirm (or decline to vacate) an award pursuant to that agreement is no different from judicial enforcement of any other contract, and falls far short of the "significant encouragement" required for state action. *See American Mfrs. Mut. Ins. Co.*, 526 U.S. at 53 ("We have never held that the mere availability of a remedy for wrongful conduct, even when the private use of that remedy serves important public interests,

so significantly encourages the private activity as to make the State responsible for it"); *Smith*, 233 F.3d at 507 ("[t]he fact that the courts enforce [arbitral awards], just as they enforce other contracts, does not convert the contracts into state or federal action"); *Davis*, 59 F.3d at 1191-92 (holding limited judicial involvement in confirmation of arbitral awards insufficient to bring conduct within ambit of Due Process Clause).

Petitioners briefly argue that private arbitration constitutes state action because arbitrators perform a "public function," and because judicial enforcement of an arbitration award constitutes "significant overt assistance" on the part of the government. Pet. at 14-15. However, neither argument is supported by this Court's precedents. *First*, arbitrators do not perform a public function at all. They are appointed by private disputants, not the state; and they award relief, including punitive damages, pursuant to the parties' contract, not in order to further the public policies applicable in civil court proceedings. *See Mastrobuono*, 514 U.S. at 58. For that reason, this case is the polar opposite of *Edmonson v. Leesville Concrete Co.*, 500 U.S. 614 (1991), which found state action in judicial enforcement of discriminatory peremptory challenges in jury selection on the ground that the "trial judge exercises substantial control over *voir dire* in the federal system." *Edmonson*, 500 U.S. at 623.

Second, the government "assistance" involved in the mere judicial enforcement of an arbitration award is a far cry from that involved in *Brentwood Acad. v. Tenn. Secondary Sch. Athletic Assn.*, 531 U.S. 288 (2001), which held that an athletic association was a state actor

in light of the "*pervasive* entwinement of public institutions and public officials in [the association's] composition and workings." *Id.* at 298 (emphasis added). Courts do not exercise similar "substantial" or "pervasive" control over the arbitral process, which is dictated by the disputants. *See Volt Info. Scis.*, 489 U.S. at 479.[4] Indeed, Petitioners' state action theory sweeps far too broadly, as it would necessarily mean that *all* judicial enforcement of private contracts constitutes state action, thereby erasing any distinction between public and private law.

B. Expanded Judicial Review Of Private Arbitration Awards Would Undermine The Efficiency And Expediency Of Arbitration As An Alternative To The Judicial System.

Petitioners' call for heightened review of arbitral awards is not only inconsistent with the FAA and this Court's precedents, it would also undermine the very purpose of arbitration. As this Court has explained, opening the door to expanded judicial review would thwart arbitration's "essential virtue of resolving

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4. Neither *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) nor *Honda Motor Co. v. Oberg*, 512 U.S. 415 (1994) supports Petitioners' argument. *Gilmer* (which involved neither punitive damages nor a due process claim) held that the limited judicial review permitted under the FAA was *sufficient* to protect the parties' rights. 500 U.S. at 32 n.4. *Honda Motor* involved an award of punitive damages by a *jury*, not by a panel of arbitrators in voluntary arbitration. In any event, the "fair notice" issue it involved is not germane to arbitration, where the parties are free to limit the penalties in advance in their arbitral agreement.

disputes straightaway" by rendering arbitration "merely a prelude to a more cumbersome and time-consuming judicial review process." *Hall Street Assocs.*, 128 S. Ct. at 1405 (quoting *Kyocera*, 341 F.3d at 998); *see also Rifkind & Sterling, Inc.*, 28 Cal.App. 4th at 1292, 33 Cal.Rptr.2d at 834 ("If the limited state involvement of converting the award into a judgment were to engender the same due process incidents required with respect to an award originally assessed and imposed by a court, the contrasting simplicity, informality, and private nature of arbitration would be seriously undermined").

This case is an unfortunate example of what one circuit has described as arbitration's perennial "poor loser problem," wherein the losing party drags the dispute through the courts in a vain attempt to obtain a better result in the courts, with the result that resolution costs more than it would have had there been no arbitration in the first place. *See B.L. Harbert Intl, LLC v. Hercules Steel Co.*, 441 F.3d 905, 913 (11th Cir. 2006). Petitioners' call for an exception to the limited review provided for under the FAA, if heeded, would only exacerbate the "poor loser" problem and force courts to develop an entirely new body of law governing punitive damage awards in arbitration. Petitioners' attempt to expand judicial review of arbitration awards is misguided, contrary to the law, unworkable and should be rejected.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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